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Environmental Damage Insurance in The Netherlands

Michael Faure

*Professor of Comparative and International
Environmental Law, Maastricht University*

INTRODUCTION

It has often been pointed out that the scope of liability of industrial operators in Europe is increasing.¹ This expanding liability seems to have affected environmental liability as well and this, combined with an increasing tendency towards intensified (command and control) regulation, has resulted in the argument that the polluter pays twice.² The recent White Paper on environmental liability, published on 9 February 2000 by the European Commission, seems, to some extent, to confirm this tendency. It proposed a strict (although non-retroactive) environmental liability for damage caused to biodiversity, if it is caused by dangerous and potentially dangerous activities, regulated by EC environment related law.³ In January 2002, as a follow-up to this White Paper, the Commission presented a proposal for a Directive, so apparently it is pursuing this idea of a European regime for 'the prevention and restoration of significant environmental damage'.

One result of the seemingly expanding scope of environmental liability is that – not surprisingly – it is causing great concern to European liability insurers. A frequent reaction, with many changes in liability law, is that as a result of this expansion, environmental liability would become uninsurable. Whether this expanding environmental liability indeed endangers the insurability of the liability risk is not a topic which will be examined in

this article.⁴ An interesting effect of these changes in liability law is, however, that both insurers and industrial operators seem to be looking for alternatives to liability insurance to cover environmental risks. Several alternatives have been developed, ranging from the use of capital markets to the installation of compensation funds.⁵

There is one particular alternative which merits a closer look. It concerns more particularly the tendency in some countries to move away from third-party liability insurance to first-party insurance. It is precisely this tendency that this article will explore. The reason is that this change from third-party to first-party insurance seems at first blush to correspond nicely with George Priest's suggestion that this would be an appropriate remedy for the American insurance crisis.⁶ Some insurers seem to have taken Priest's warnings of a liability crisis seriously and the same is apparently true for the remedies he proposed. There is, especially in the environmental sphere, an increasing tendency towards first-party and direct insurance. This is, by the way, not only the case in the environmental area, but also, for example, in occupational health and medical malpractice, and an increasing use of first-party insurance is even under

1 See, for example, J. Spier (ed.), *The limits of liability, keeping the floodgates shut*, The Hague, Kluwer, 1996 and *De uitdijende reikwijdte van het aansprakelijkheidsrecht*, pre-advies Nederlandse Juristenvereniging.

2 Meaning that the polluter on the one hand has to invest heavily to be able to comply with the conditions of a licence and on the other has also to pay for the remaining environmental damage. See in this respect especially L. Bergkamp, *De vervuiler betaalt dubbel*, Antwerpen, Intersentia, 1999.

3 For a comment on this White Paper see P. Rice, 'From Lugano to Brussels via Aarhus: environmental liability white paper published', *Environmental Liability*, 2000, at 39 to 45 and E. Rehinder, 'Towards a Community environmental liability regime: the Commission's white paper on environmental liability', *Environmental Liability*, 2000, at 85 to 96.

4 In another study, it has been held that, provided that the economic principles of insurance are respected (such as some degree of foreseeability and predictability of the risk) the mere fact of expanding liability should not as such endanger insurability. See M. Faure and D. Grimeaud, *Financial assurance issues of environmental liability*, final version 4 December 2000, which contains an analysis of the insurability of the regime proposed by the white paper on environmental liability. This study has been made available electronically via the Commission's website: <http://www.europa.eu.int/com/environment/liability/followup.htm>. For a summary of this study see M. Faure, 'The White Paper on Environmental Liability: efficiency and insurability analysis', *Environmental Liability*, 2001, at 188 to 201.

5 For an overview of alternatives see J.R. Tyran and P. Zweifel, 'Environmental risk internalization through capital markets (Ericam): the case of nuclear power', *International Review of Law and Economics*, 1993, at 431 to 444; M. Radetzki and M. Radetzki, 'Private arrangements to cover large-scale liability caused by nuclear and other industrial catastrophes', *The Geneva Papers on Risk and Insurance*, 2000, at 180 to 195.

discussion in the traffic accident area. Therefore, this phenomenon definitely merits a closer look.

This article will first of all look at the theoretical differences between first-party and third-party insurance. The question arises how, at least in theory, the two differ as far as their ability to prevent environmental harm is concerned, as well as in the provision of adequate compensation to accident victims. Then we will take a practical example provided by The Netherlands since Dutch insurers recently decided to more or less abolish environmental liability insurance and change radically to environmental damage insurance. We will have a critical look at this policy and examine whether this is indeed an example which should be followed by other countries. All of these issues will be addressed by an economic analysis of tort and insurance. The reason for using the law and economics method is obvious: it provides adequate tools to examine critically whether various insurance devices can lead to optimal prevention and compensation. The article ends with a few concluding remarks.

FIRST-PARTY VERSUS THIRD-PARTY INSURANCE: THEORETICAL DIFFERENCES

Introduction

In the economics of accident law and insurance the reasons why persons seek insurance coverage have been explained. The utilitarian approach with respect to insurance has demonstrated that risk creates a disutility for people with risk aversion. Utility can be increased in case of loss spreading or if the small probability of a large loss is removed from the injurer in exchange for the certainty of a small loss.⁷ The latter is of course exactly the phenomenon of insurance. There is a demand for insurance on the part of a risk-averse injurer; he prefers the certainty of a small loss (the payment of the insurance premium) whereby the probability of a larger loss is shifted to the insurance company, thereby increasing the utility of the injurer.⁸ It is remarkable that in this utilitarian approach of insurance, liability insurance is first of all regarded as a means of increasing the utility of a risk-averse injurer, rather than as a means of protecting victims, as is sometimes argued by lawyers.

The reason an insurance company can take over the risk of the injurer is well known: because of the large number of participants the risk can be spread over a bigger group of people. The insurer has only to take care to create relatively small risk groups in which the premium is as closely as possible aligned to the risk of the members of that group.

In addition to this utility-based theory of insurance which sees insurance as a instrument to increase the expected utility of risk-averse persons through a system of risk-spreading, Skogh has powerfully argued that insurance may also be used as a device to reduce transaction costs.⁹

Thus one can easily use these general principles to explain why there will be a demand for environmental liability insurance: it can provide protection for risk-averse injurers. However, it has been argued that several conditions have to be met to keep (environmental) liability an insurable risk. The question we are interested in within the scope of this article is obviously whether conditions of insurability might be easier to meet in the case of first-party than in the case of third-party insurance.

Advantages of a first-party insurance scheme

Risk differentiation: theory

The advantages of a first-party insurance scheme are more particularly to be found at the level of risk differentiation. Let us first discuss the importance of risk differentiation more fully and then address the question why risk differentiation may be easier in first-party insurance.

George Priest has claimed that the adverse selection problem has caused an insurance crisis in the United States and that it can only be cured by an appropriate differentiation of risk.¹⁰ If the insurance policy requires preventive action from the insured party and provides for a corresponding reward in the premium, this should give optimal incentives to the insured for accident reduction. Thus risk pools should be constructed as narrowly as possible so that the premium reflects the risk of the average member of that particular pool.¹¹

A further differentiation of the risk is obviously only efficient as long as the marginal benefits of this further

6 G. Priest, 'The current insurance crisis and modern tort law', *Yale Law Journal*, 1987, at 1521 to 1590.

7 See K. Arrow, *Aspects of the Theory of Risk-Bearing*, Helsinki, Yrjö Jahnssoonin Säätiö, 1965 and K. Borch, 'The Utility Concept Applied to the Theory of Insurance', *The Astin Bulletin*, 1961, at 245 to 255.

8 See S. Shavell, *Economic analysis of accident law*, Cambridge, Harvard University Press, 1987, at 190.

9 G. Skogh, 'The transactions cost theory of insurance: contracting impediments and costs', *Journal of Risk and Insurance*, 1989, at 726 to 732.

10 G. Priest, Note 6 above, at 1521 to 1590. Priest has been criticised by Viscusi, who claims that there were other reasons for the product liability crisis in the United States than adverse selection on its own (W.K. Viscusi, 'The Dimensions of the Product Liability Crisis', *Journal of Legal Studies*, 1991, at 147 to 177).

11 K. Abraham, 'Environmental Liability and the Limits of Insurance', *Columbia Law Review*, Vol. 88, 1988, at 949 to 951.

differentiation outweigh the marginal costs of such a differentiation.¹² Risk differentiation certainly does not mean that insurers would have to use an individual tariff in each case.¹³ The possibilities for individual differentiation will inevitably also depend on the value of the particular insurance policy. For mass insurance products with a low premium, risk differentiation can only take place in general categories. In professional liability insurance of enterprises, however, the benefits of detailed differentiation, rewarding an enterprise for preventive action, may well outweigh the costs.

It is thus not difficult to make an economic argument in favour of effective risk differentiation as a remedy for a growing liability risk. If good risks are not rewarded for preventive action, either they will not have an incentive for prevention or they will leave the risk pool, and consequently the risk pools will be unravelled, as described by Priest.

First-party insurance: theory

Liability insurance is a third-party insurance, whereby the insurer covers the risk that his insured (the potentially responsible party) will have to compensate a third party. A first-party insurance is a system whereby insurance cover is provided and compensation is awarded directly by the insurer to the victim. Whether such first-party insurance can be considered to be an efficient alternative to third-party liability can not be answered in general terms. It depends to a large extent on the details of such a system and more particularly on the question whether or not first-party insurance is combined with liability of the potentially responsible party.

The underlying principle in first-party insurance is that the insurance undertaking – in principle – pays as soon as damage occurs, provided that it can be proved that the particular damage has been caused by the insured risk.

Payment by the insurance undertaking occurs irrespective of whether there is liability. The arguments advanced in the literature in favour of first-party insurance are that the transaction costs would be lower and that risk differentiation might be a lot easier.¹⁴ The reason is simply that with first-party insurance the insurer directly covers the risk of damage with a particular victim or a particular site. The idea is that it is therefore much easier for the insured to signal particular circumstances which may influence the risk to the insurer. The problem with liability insurance is that the insurer is always insuring the risk that his insured (the potential injurer) will harm a victim (a third party) of which the properties are unknown *ex ante* to the insurer. Moreover, under liability insurance there are many unknowns, for example how the judge will interpret this specific liability of the insured. In the ideal world of first-party insurance the insurer directly covers the victim, and thus the risk. He can therefore monitor the risk directly and in principle provide a much better risk differentiation.¹⁵

If one takes the importance of risk differentiation and the risks of adverse selection as seriously as Priest did, the shift towards first-party insurance seems to be most promising. One can – at least on a theoretical level – understand why first-party insurance would be beneficial to insurers: it is obviously much easier to control and assess *ex ante* the risk that a particular victim might suffer damage instead of assessing the risk that his insured potential injurer might cause harm to a third party and thus be found liable. There are indeed many more uncertainties in third-party liability, which could make adequate risk differentiation more complex. Obviously within liability insurance risk differentiation is possible as well, in the sense that, as explained above, the insurer can adequately monitor whether his insured is a good or a bad risk (for example, in the sense of taking preventive measures), which could then be rewarded with a lower or higher premium. But even if an ideal risk differentiation were applied, there are still many uncertainties in liability insurance. For instance, it will depend on the state of case law and interpretation by judges whether the insured potential injurer will be found liable for specific behaviour and specific damage; it is

12 Generally the question is whether the benefits of particularisation outweigh their costs, and has to be addressed in tort law when a standard of care is defined (R. Posner, *Economic Analysis of Law*, 5th edition, New York, Aspen Law & Business, 1998), but also when legal rules are made (I. Ehrlich and R. Posner, 'An Economic Analysis of Legal Rule-Making', *Journal of Legal Studies*, 1974, at 257) or standards are set (A.I. Ogus, 'Quantitative Rules and Judicial Decision-Making', in Burrows and C. Veljanovski (eds), *The Economic Approach to Law*, London, Butterworth, 1981, at 210 to 225; A.I. Ogus, 'Standard Setting for Environmental Protection: Principles and Processes', in M. Faure, J. Vervaele and A. Weale (eds), *Environmental Standards in the European Union*, 1994, at 25 to 37).

13 On the costs of risk differentiation, see S. Bohrenstein, 'The Economics of Costly Risk Sorting in Competitive Insurance Markets', *International Review of Law and Economics*, 1989, at 25 to 39; and W.P.J. Wils, 'Insurance Risk Classifications in the EC: Regulatory Outlook', *Oxford Journal of Legal Studies*, 1994, at 449 to 467.

14 This argument is, again, especially advanced by G. Priest, 'The current insurance crisis and modern tort law', *Yale Law Journal*, 1987, at 1521 to 1590.

15 Many other law and economics scholars have pointed to the advantages of first-party insurance. See for example W. Bishop, 'The Contract-Tort Boundary and the Economics of Insurance', *Journal of Legal Studies*, vol. 12, 1983, at 241 to 266 and R.A. Epstein, *Simple Rules for a Complex World*, Cambridge, Harvard University Press, 1995, at 221 and, in the product liability area, R.A. Epstein, 'Products Liability as an insurance market', *Journal of Legal Studies*, vol. 14, 1985, at 645 to 669.

apparently this uncertainty caused by judges in particular which insurers dislike. Moreover, with third-party liability insurance it is *ex ante* not possible to know whether the insured injurer will cause damage to a very high income or a very low income victim. That type of uncertainty can of course be avoided under first-party insurance where – at least in the ideal situation – the victim chooses *ex ante* the insurance cover he wishes according to his own demand and expected losses.

Notwithstanding these theoretical advantages, several questions still remain. More particularly the question arises how this scheme could be used to enhance the insurability of the environmental risk, which is the central topic of this article.

Direct insurance for environmental risks: a few questions

Let us now see how first-party insurance could be used as an alternative to liability insurance to cover environmental risks. Several practical questions will arise.

First-party versus direct insurance

As has been mentioned above, first-party insurance is based on the principle that the victim seeks cover directly from the insurer. Such a system can of course hardly be applied to its full extent in the environmental sphere. Theoretically, in pure first-party insurance it is the victim who takes out insurance cover and who therefore also pays the premium. Such a pure first-party insurance scheme would probably not be very practical for environmental risks, unless one imagines industrial operators seeking cover, say for the pollution that may occur on their own plant. In that case, the operator would, in first-party insurance, seek cover for the damage he might suffer himself. Otherwise first-party insurance would mean that private citizens who are afraid of suffering environmental harm, for example in their garden, seek insurance cover themselves.

However, there is an alternative which looks like first-party insurance, and which is called direct insurance. In a direct insurance scheme one would imagine the potential polluter, for example, the owner of a particular site who seeks insurance cover providing protection also to third parties who could suffer damage resulting from that particular site.

Such a direct insurance scheme is applied in some countries with respect to occupational health. In that case, for example, the employer would take out insurance cover on behalf of his employees, who could claim directly on the policy. Under direct insurance the policyholder is not the victim, but the potential injurer. It is, however, not a liability insurance since the trigger to compensate is no longer liability, but the mere existence of damage.

For environmental risk one could thus consider both pure first-party insurance, where potential victims cover losses themselves, and direct insurance, where a potential polluter seeks insurance coverage also to the benefit of a third party (the victim). As will be seen below, in practice there may be a combination of first-party and direct insurance, for example where the owner of a particular site, where, say, soil pollution might occur, could seek cover both for his own damage and for the damage that may be caused to third parties.

Scope of cover and causation

The main difference between traditional liability insurance and either pure first-party or direct insurance is that cover under the latter is no longer for liability. Hence, a consequence (and, insurers claim, an advantage) is that liability is no longer required in order to be able to claim on the policy. Traditional insurance would say that one would need an 'accident'. However, it is well known that, given the gradual nature of many pollution cases, these can hardly be considered to be sudden events, which accidents are. Therefore, in environmental insurance damage will probably suffice, but it will be important to describe clearly what constitutes an insured damage which may give rise to a claim on the policy.

Depending on how this is formulated in the policy, the insured will have to claim that his damage is caused by the insured activity. In the case of direct insurance which benefits third-party victims, problems could arise if there are multiple causes. In that case the victim will obviously have to claim and prove that his damage was caused by the particular insured risk.

However, with environmental damage insurance causation does not seem to be a major problem (other than that it may always be a problem in any environmental liability case as well). This is different in cases where first-party insurance solutions are presented for health damage, such as in case of medical malpractice or for occupational diseases. In all of those cases the difficulty will be that the question will have to be settled whether the personal injury suffered by the victim is actually caused by medical malpractice or by an occupational disease. Causation issues which relate to the fact that it should be clear that the harm is caused by the insured risk, may arise also in environmental insurance, but seem less serious than in cases where personal injury is insured.

Financing

Although less interesting from a theoretical perspective, a practical question that will always arise at the policy level is who should pay for a first-party or direct insurance

scheme. A consequence of a pure first-party system is that theoretically it is the victim who seeks insurance coverage himself and who therefore finances first-party insurance. To the extent that this victim is also the industrial operator who caused the risk, polluter and victim will be the same and it will effectively be the polluter who finances the insurance. If, however, one adopted a first-party insurance scheme for 'innocent' victims, politicians would probably argue that now victims are forced to finance, say, the clean-up of the polluted soil in their own garden (by paying the premium for the first-party insurance) whereas the polluter should pay for this. The answer would obviously be that if the first-party insurer of the 'innocent' victim were allowed a right of redress against the polluter, the polluter pays principle would still be satisfied and the polluter would still be given appropriate incentives for prevention.

However, it is most likely that at the policy level discussions would primarily go in the direction of a direct insurance since under such a system the polluters finance the insurance cover, including the damage caused to third-party victims.

Prevention

A question which will obviously be asked is how polluters are given appropriate incentives for prevention of environmental harm if the risk is fully covered under insurance. The answer here is that it is no different from traditional liability insurance. All insurance systems potentially lead to the well-known moral hazard problem.¹⁶ But we have equally indicated that an adequate risk differentiation can be the appropriate remedy to moral hazard. First-party and direct insurance schemes were precisely advanced because they could enable a better risk differentiation. If that were the case, they could even lead to better results as far as prevention is concerned.

In practice, the risk differentiation under first-party and direct insurance would mean that, for example, if a particular site were insured, the insurer would use all the *ex ante* monitoring and *ex post* devices to check the 'ecological reliability' of the particular operator, which should provide optimal incentives for prevention. Hence, if the theoretical possibilities of risk differentiation are used in an optimal manner, first-party or direct insurance schemes should cause no problem as far as prevention is concerned.

Relationship with liability law

An interesting issue, since liability is no longer the trigger for cover, is of course the relationship to liability law. In many instances where first-party or direct insurance schemes are advanced (such as in the areas of medical malpractice and occupational health) those schemes are often supposed to totally replace the liability system. There is, for example, in the area of occupational health in many European systems a direct insurance scheme (providing coverage to all insured employees of one employer) with an immunity for liability of the employer, except in case of intent or gross negligence. In many countries these insurance systems are imbedded in social security law.

A traditional argument, for example in the area of medical malpractice, against first-party (patient) insurance schemes and in favour of tort law is that the incentives of the healthcare provider would be diluted without a liability system.¹⁷ On a theoretical level there would be no reason to grant immunity to the polluter even if, say, a mandatory first-party or direct environmental insurance scheme were introduced. Even if a third-party victim were compensated by the insurer, it would still be possible to use liability law (via the right of recourse) to provide appropriate incentives for prevention with the polluter. Therefore, there seems to be no reason to let a first-party insurance scheme replace liability law.

Notwithstanding this theoretical starting point, it may be noted in practice that first-party or direct insurance schemes are often only accepted (that is, their mandatory introduction) if, for example, in the area of occupational health the potential injurer (the employer) receives some kind of 'compensation' in the form of a partial immunity of liability.

Guarantee of coverage

Finally one could ask to what extent a first-party or direct insurance scheme can provide a guarantee that funds will indeed be available at the crucial moment when they are needed, for example when polluted soil needs to be cleaned up. This question has important policy implications and has several aspects. First of all, it relates to the question whether compulsory first-party or direct insurance scheme should be introduced. Indeed, the market could work out wonderful insurance devices, but if no operator made use

16 See G. Wagner, 'Versicherungsfragen der Umwelthaftung' in M. Ahrens and J. Simon (eds), *Umwelthaftung, Risikosteuerung und Versicherung*, Berlin, Erich Schmidt Verlag, 1996, at 104 to 105 and S. Shavell, 'On Moral Hazard and Insurance', *Quarterly Journal of Economics*, 1979, at 541 to 562.

17 See, for example, P. Danzon, 'Alternative liability regimes for medical injuries', *Geneva Papers on Risk and Insurance*, 1999, at 3 to 22 and see Koziol, 'Die Arzthaftung im geltenden und künftigen Recht', in *Haftungsrechtliche Perspektiven der Ärztlichen Behandlung*, Linz, Universitätsverlag Rudolf Trauner, 1997, at 21 to 35.

of them, there would still be no guarantee that, given the insolvency risk, funds would effectively be available when needed. However, that is obviously not a problem peculiar to first-party insurance, but a more general problem relating to whether at policy level a duty to seek financial coverage for environmental risk should be introduced. An issue which is related to direct insurance is whether one can provide for a third-party victim's direct right of action. This concerns those situations where the insurance policy of the industrial operator provides that his coverage also extends to damage caused to third parties. Normally these third parties do not, given privity of contract, have a claim on the insurance policy, unless they are formally made a third-party beneficiary of the policy which provides for direct insurance. Hence the question arises whether one can see those third-party beneficiary clauses in practice.

After having identified the potential benefits and several points relating to first-party and direct environmental insurance, let us now look at how these new policies are introduced in practice.

ENVIRONMENTAL DAMAGE INSURANCE IN PRACTICE: THE DUTCH EXAMPLE

The trend towards first-party cover

At the end of the last section it was indicated that although first-party insurance might in theory seem very attractive at first sight, since it might better enable a narrowing of risk pools, still a lot of questions arise, especially in its application to the environmental risk. It is probably best to examine these questions by looking at a practical example where first-party insurance of polluted sites has been implemented.

Before doing so it is probably important to stress that this exposé on first-party insurance is not merely theoretical, but does indeed have a certain practical relevance. Indeed, the General Liability Committee of the Comité Européen des Assurances (CEA) has carried out a study on first-party legal obligations for clean-ups and corresponding insurance covers in European countries.¹⁸ This study shows that although the insurance situation between the European countries still differs to a large extent, first-party insurance cover seems to be available in several Member States.¹⁹ In one country, that is, The Netherlands, the insurers have deliberately chosen to provide cover of polluted sites on a first-party basis. The

idea is that the first party cover should replace traditional environmental liability insurance. So it seems interesting to take a closer look at the insurance situation in The Netherlands.

Environmental damage insurance in The Netherlands

Dissatisfaction with existing cover

The starting point for the Dutch insurers' concern lay in the fact that all the theoretical problems discussed above concerning the insurability of environmental liability had also played a major role in the Dutch environmental practice. This had to do with the fact that environmental risk is an example of a 'long-tail risk', where the insurer today could be confronted with events which occurred in the distant past and would lead to liability of the insured now. Insurers held that this generally endangered the predictability of the risk.

Most of these problems were therefore related to the fact that environmental harm does not constitute a sudden event, as is the case with most 'traditional' accidents which are insured in liability insurance.

The Dutch insurance market therefore used to have the environmental risk covered through a variety of insurance policies, of which the most important were:

- The liability insurance policy (AVB)²⁰ for sudden risks and occupational health risks which were related to the environment;
- The environmental liability insurance (MAS) for risks of a more gradual nature, not including personal injury;²¹ and
- Fire insurance for clean-up costs after fires (although the precise coverage of that policy was debated).

This environmental liability insurance was provided by an environmental pool, referred to as MAS.²² In this MAS 50 (re)insurers work together to cover environmental liability risk. The MAS was hence constructed as an environmental pool, although the individual insurers, which were connected to the MAS, contracted individually the MAS policy under their own label.

There was, however, a lot of criticism of that system, which can be summarised as follows.²³

20 Aansprakelijkheidsverzekering bedrijven.

21 See on that policy J.H. Wansink, 'De nieuwe milieuaansprakelijkheidsverzekering', *Milieu en Recht*, 1985, 98.

22 Milieu-aansprakelijkheidsverzekering Samenwerkingsverband.

23 I am grateful to Mr P.A.J. Kamp of Nationale Nederlanden who has provided further insights for the reasons behind the changes towards first-party insurance in The Netherlands.

18 CEA, *Study on first party legal obligations for clean-ups and corresponding insurance covers in European Countries*, Paris, CEA, 21 October 1998.

19 See the summary tables in the CEA study, 32.

- First of all, the whole division of cover between the AVB and the MAS was based on the idea that the AVB would cover sudden risks and the MAS would cover risks of a more gradual nature. As is well known, in practice it was not always possible to make a clear distinction between sudden and gradual risks, which led to uncertainties concerning the scope of the cover of both policies. This was obviously the result of the fact that the Dutch insurers decided not to exclude the environmental risk altogether from the traditional liability insurance of companies (AVB).²⁴
- The environmental liability policy (MAS) was considered to be rather complicated and had a very complicated procedure for accepting those to be insured. The policy was, in addition, rather expensive and hence difficult to sell.
- A further problem was that neither the general environmental liability policy (AVB) nor the environmental liability insurance policy (MAS) provided any cover for damage caused to the insured's own site. This caused a problem for the insured, since according to the case law of the Dutch Supreme Court companies could be held liable for pollution of their own site. In addition, the fact that pollution of the insured's site was not covered inevitably again caused uncertainty as to the scope of the cover. One could imagine cases where, for example, polluted groundwater went from the site of the insured to a neighbouring site. This caused problems since pollution of the neighbour's site was insured whereas pollution of the insured's own site was not.
- Furthermore, there were more uncertainties concerning the question of whether clean-up costs were covered under the fire insurance policy. The fire insurance covers, under clean-up costs after fire, any environmental damage, but only on condition that there was a prior fire. In the fire insurance policy no account was taken of the fact that after a fire serious soil and water pollution could also occur. It was not always clear whether the soil clean-up costs, resulting from the fire, were also covered under the fire insurance.
- Finally there were obviously all the traditional problems related to environmental liability, such as the question whether a specific damage was indeed caused as a result of an insured risk. Also case law concerning environmental

liability has developed in such a way in The Netherlands that had not been foreseen by insurers. Hence, liability risk was increasingly considered unpredictable and therefore uninsurable as far as environmental harm was concerned.

Environmental damage insurance: main features

This led the Dutch Insurers Association in 1998 to present a new product, the environmental damage insurance (MSV).²⁵ This policy has been available since 1 January 1998 and it takes a revolutionary different approach from traditional environmental liability insurance.²⁶

This new environmental damage policy provides for various new elements. First of all it provides integrated cover of all environmental damage which occurs on or from the insured site. A prerequisite is that it concerns pollution of soil or of water. The integrated cover means that the new environmental damage insurance will replace traditional pollution insurance (for sudden pollution) in the AVB and the liability insurance of the MAS (for gradual pollution).

The whole idea is that this cover constitutes direct insurance. In other words, the insured site is insured, even when clean-up costs have to be made on a third party's site. Coverage takes place as soon as the insured site is polluted as the result of the insured risk, irrespective of whether or not the insured could be held liable for the damage. In some cases the third party (the victim) receives direct action on compensation on the basis of the environmental damage insurance policy. The trigger for compensation under this policy is therefore no longer tort law, but the insurance policy as it has been concluded between the insured and the insurance company. This is typically first-party insurance or, as it is called in The Netherlands, direct insurance. It is direct insurance to the extent that it also benefits third parties. It is indeed not the third-party victim who purchases insurance (although the insured may be the victim), but someone who has responsibility for a site on or from which water or soil pollution may occur. The policy benefits third parties as well.

25 Milieuschadeverzekering.

26 For a good description of the new policy see J.H. Wansink, 'Verzekering en milieuschade als gevolg van vervoer/opslag van gevaarlijke stoffen', *Tijdschrift voor Milieuaansprakelijkheid*, 1999, 77-82 as well as C.A. Janssen, 'Aansprakelijkheid voor milieuschade en financiële zekerheid naar toekomstig recht: nieuwe oplossingen. Nederlands Recht' in L.F. Wiggers-Rust, and K. Deketelaere (eds), *Aansprakelijkheid voor milieuschade en financiële zekerheid*, Die Keure – Vermande, 1998, at 111 to 112 and P.J.M. Drion, 'Milieu onder één dak: milieuschadeverzekering (MSV)', *Verzekeringsrechtelijke Berichten*, 1998/2, at 19 to 21.

24 For further details on these difficulties see J.H. Wansink, 'Hoe plotseling en onzeker is de verzekeringsdekking voor milieuaansprakelijkheidsrisico's?' in *Miscellanea Jurisconsulto vero dedicata*, Essays in honour of Professor J.M. van Dunné, Deventer, Kluwer, 1997, at 451 to 460.

Obviously environmental damage insurance cannot set aside tort law, but the main advantage according to Dutch insurers is that cover is not triggered on the basis of liability. The advantage from the victim's point of view is obviously that cover can be provided more rapidly and probably at lower cost than through the court cases which are necessary as a result of liability law.

Environmental damage insurance as provided by the Dutch Insurers Association has several categories with different policies. The insured can opt for various insurance policies. This obviously shows that first-party insurance better enables an optimal risk differentiation since every insured will be able to purchase insurance cover according to his own preferences. The damage to the insured location itself is insured. This at least provides cover for clean-up costs and this is rather broadly defined. The cost of repairing the damage is also included. Soil pollution, which is also envisaged, obviously falls within the environmental damage insurance. Note, however, that under this policy it are only the costs of 'clean-up' which are covered.²⁷ Also the damage caused from the insured site and suffered by third parties is covered. This clearly provides a broader scope of protection.

The insured remains in principle fully liable, although the third party (beneficiary) that would be protected under the new MSV policy could claim directly on the policy and would hence in principle have no interest in using liability law. However, it might be that the insured has taken out too limited cover and that in that particular case the third party would still (have to) use liability law. In that case the liability itself is not covered (and an insolvency risk remains), but the MSV policy provides for legal assistance in a couple of specific cases.²⁸ This is the case if, for example, the sum which is insured under the MSV cover was not sufficient, say, to pay for the clean-up costs incurred by the government; or if a third party chooses liability law instead of direct action under the MSV policy.²⁹

The main feature of the new environmental damage insurance provided in The Netherlands is obviously that it is no longer liability insurance, but only first-party (or direct) insurance. The advantage for the insurer (and for the insured) is that the difficult road of liability law is excluded. Whether liability law will still be used is

uncertain. Third parties could still use liability law, although it is easier for victims to use the direct action provided under the MSV policy. There is, however, one important weakness, which unavoidably remains, the fact that environmental damage insurance is not compulsory. Hence, there may remain situations where companies in The Netherlands have purchased no insurance coverage at all or situations where only a basic cover was taken out for damage on the particular site, but only to a limited extent for damage to third parties.³⁰ In those cases third parties claiming against the responsible party might still be confronted with an insolvent polluter. Moreover, the new MSV regime is exclusive, meaning that cover for (sudden) soil and/or ground water pollution has now been removed from the liability insurance policy. This means that if an insured had, for example, only taken an MSV cover for the insured site and a loss had occurred to a third party on another site, this third party would probably use liability law against the polluter. In that particular case the polluter cannot call on his general liability insurance (AVB) since environmental risks have now been removed from that policy as a result of the MSV entering into force.³¹

But that can hardly be considered a weakness in the system of first-party insurance: the insured does not get more than what he pays for. Since the MSV is a general policy with a lot of options for the insured, premiums and amount of cover can vary. The type of costs which are insured are, however, identified in the general policy and according to the CEA study on first-party insurance the total amount of cover available under this new environmental damage insurance in The Netherlands would be 25 million Dutch guilders.

Evaluation

Mixed first-party and direct insurance

If we turn back to the specific questions relating to first-party/direct insurance it may be noted that the Dutch scheme is apparently a mix of first-party and direct insurance. It is principally first-party insurance in the sense that the insured site of the potential polluter is covered. It is also a direct insurance since the policy provides that not only damage on the insured site itself is covered, but also damage suffered by a third party.

The trigger for cover is no longer liability, but damage. There is a clear causation requirement in the policy, since

27 Article II.1.1. defines as the scope of coverage: 'Insured are the costs of remediation of the insured site. This remediation must apply to a pollution which is the direct and exclusive result of an emission, caused by one of the insured risks ...'

28 This legal aid cover, however, is not applicable if the insured takes out a low amount of cover.

29 See J.H. Wansink, 'Verzekering en Milieuschade als gevolg van vervoer/opslag van gevaarlijke stoffen', *Tijdschrift voor Milieuaansprakelijkheid*, 1999, at 81.

30 In principle damage caused from the insured site to third parties is always covered, but the amounts of cover may be limited.

31 J.H. Wansink, 'Verzekering en Milieuschade als gevolg van vervoer/opslag van gevaarlijke stoffen', *Tijdschrift voor Milieuaansprakelijkheid*, 1999, at 81 to 82.

it requires that pollution must be the direct and exclusive result of an emission caused by one of the insured risks. Moreover, only the costs of remediation of the insured site are covered, which excludes the uncertainties involved in assessing environmental damage. Insofar as the insurance policy also covers the damage suffered by third parties, it effectively functions as a liability cover.

Advantages

The advantage for the insured is clearly that this first-party insurance now provides cover for damage to the site of the insured as well. That is a major change. Very often public authorities used to force polluters to clean up their own polluted soils. Formally this was not construed as liability and therefore no insurance cover was available.

As far as prevention via optimal risk differentiation is concerned, insurers claim that this policy for them has the major advantage that they can adequately control *ex ante* the quality of a particular soil and the production methods applied by the insured. On that basis an adequate assessment of the risk can be made.

However, some company lawyers have been critical of this new insurance product. They argue that in practice insurers are so critical in providing cover that effectively only the very good risks would be able to receive cover.³² Hence, they claim that one can not blindly argue that environmental damage insurance is a remedy for all insurability problems relating to environmental risks. Indeed, the flip side of an effective *ex ante* monitoring is obviously that insurers could choose either only to cover good risks or to cover bad risks only for a high premium. But one can hardly reproach the insurers for applying insurance economic principles correctly.

According to information provided by the Dutch Insurance Association this new product works remarkably well. They claim that business interest in this new environmental damage insurance is much greater than in traditional environmental liability insurance. Whether this new product is actually a success is more difficult to judge. There is, however, undoubtedly an increasing interest on the part of industry in this new environmental damage insurance. The fact that greater financial security for environmental damage is provided in The Netherlands as a result of this product should definitely be considered as positive. Moreover from the victim's (mostly the government's) perspective, the fact that environmental damage insurance provides for direct action for victims

should be considered to be positive as well. However, one should note that this third-party action right only applies if the insured has accepted this.

Moreover, the advantage for the insured is that under this environmental damage insurance damage caused to his own site is also covered, which was obviously not the case under liability insurance.³³ If, on the policy level, one concluded that an environmental liability system should be combined with some form of guarantee that financial security was available, one should at least leave the option open to industry to provide this financial security via environmental damage insurance. The Dutch example shows that this first-party type coverage seems able to meet that end.³⁴ Moreover, the example seems to be followed in other countries as well.³⁵

Disadvantages

However, there are inherent limitations to this new environmental damage policy as well. First of all, one should note that this new insurance product applies only to soil pollution, ground water pollution and the subsequent remediation costs. It is therefore not a solution in case of other types of environmental harm like noise, surface water pollution or air pollution. But it is also more difficult to apply liability law to those types of environmental damage as well.

Another point of criticism is that the amount of cover that would be available seems to be relatively low. The CEA study reports that the amount of cover available would be 25 million Dutch guilders. This would be sufficient to cover the average clean-up costs in case of soil pollution, but not for bigger cases. However, in practice policies are not always issued for this maximum amount of 25 million.

The fundamental question that may also be asked at a policy level is whether the introduction of this new

33 H. Cousy, 'Recent developments in environmental insurance', in F. Abraham, K. Deketelaere and J. Stuyck (eds), *Recent economic and legal developments in European environmental policy*, at 240.

34 Also Bergkamp argues strongly in favour of first-party and against environmental liability insurance (L. Bergkamp, 'The Commission's White Paper on Environmental Liability: A weak case for an EC Strict Liability Regime', *European Environmental Law Review*, 2000, at 112 to 114).

35 Ranson reports that also in Belgium a 'direct' environmental insurance would be offered which would also cover gradual pollution (but would exclude ecological damage). See D. Ranson, 'Verzekering van milieuaansprakelijkheid', *Milieu- en Energierecht*, 2000, at 68. The new policy would also cover, like the Dutch example, remediation costs. It would be offered by AIG and would provide coverage up to 1 billion BEF (see H. Kerremans, *Aansprakelijkheid voor Milieuschade en verzekeringsmogelijkheden in Milieuzorg in de Onderneming, I., Juridische, fiscale en organisatorische aspecten*, Antwerpen, Standaard, at 537 to 583).

32 J. Niezen, 'Nieuwe milieuschadeverzekering - geen panacee', *Milieu en Recht*, 1998, at 114.

environmental damage insurance was really necessary to deal with the uncertainties of environmental liability, as the Dutch insurers claimed. One could argue that the tricky aspects of environmental liability, such as causal uncertainty and long-tail risks could be dealt with either by the legislator or through adequate policy provisions. Note that as a reaction to the long-tail risk caused under liability insurance, claims-made coverage was introduced. But this also applies in the MSV. Moreover, the risk differentiation may theoretically be easier in first-party insurance, but if liability insurers monitor potential polluters adequately (and it is doubtful whether that happened in the past) the risk differentiation in environmental liability becomes as adequate as in first-party insurance. One has the impression that the real reason that Dutch insurers moved to environmental damage insurance was that they wanted to exclude the uncertainties having to do with the involvement of the judge (will there be wrongfulness, liability in this particular case? Will he accept causation or not?).

The insurers may now have excluded a lot of these uncertainties, but these will remain for polluters who are still fully exposed to environmental liability. This leads to a particular tricky aspect of the new regime, which really is a source of worry. This is the fact that the environmental damage insurance introduced by the Dutch insurers is a completely voluntary system, introduced without any government intervention. A consequence is then also that liability law is not affected by this regime at all. Victims suffering harm as a result of soil pollution can still sue the polluter. If the insured has accepted the possibility of third parties claiming, the victim can even claim directly on the policy as third-party beneficiary. If, on the other hand, the MSV policy does not contain a third-party beneficiary clause, the victim will, just as is the case today in The Netherlands, have to sue the liable polluter. A problem in that case is, however, as we indicated above, that the MSV is supposed to replace liability insurance, meaning that liability insurance will no longer be available, at least for the environmental risks covered under the MSV. This new MSV is supposed to replace the general liability insurance, at least for the environmental risks covered under the MSV. As a result of this, industrial operators in The Netherlands today no longer have the possibility of obtaining liability coverage for their environmental risks. Third parties who suffer harm may be protected under the new MSV, but only under the assumption that the MSV coverage is sufficient to cover their losses. If this is not the case, the third party will simply have to use tort law and bring a lawsuit against the polluter. But then the problem may arise that this polluter no longer is covered under liability insurance.³⁶ The victim then may find his defendant to be judgment-proof.

CONCLUDING REMARKS

In this article special attention has been given to a new environmental insurance product which was introduced recently in The Netherlands, but which is gaining popularity in other countries as well. The reason for paying that much attention to this new product, referred to as environmental damage insurance, is that the insurers claim that many of the problems that arise when insuring the environmental risk are in fact problems related to environmental liability. In other words: they claim that the environmental risk would be better insurable if the risk could be insured on a first-party basis. Many of the problems that appear under liability insurance would then disappear, or at least be reduced, so it is held.

From a theoretical perspective, the Dutch insurers certainly have a point. Already in 1987 George Priest claimed that the American liability and insurance crisis was caused by a shift from first-party to third-party insurance. The obvious remedy for him was to move back from third-party (liability) insurance to first-party insurance. However, although the first-party model seems an appropriate remedy for problems in liability cover, in fact it is only for one aspect of the insurability of the environmental risk, the issue of risk differentiation. Indeed, first-party insurances are held to enable a better risk differentiation than traditional liability insurance. Of course this is an important issue since adequate risk differentiation has always been advanced as the appropriate remedy for the dangers of moral hazard and adverse selection. But on the other hand, other problems concerning the insurance of environmental risk will remain. This concerns, for instance, the issue of limited capacity in case of catastrophic environmental accidents, the risk of judges shifting causal uncertainty to an industrial operator and the danger of a retrospective application of liability laws. Indeed, also under first-party insurance, capacity will not be unlimited; first-party insurance requires a condition of causation (it must be proved that the damage was caused by the insured risk) and the problem of retroactive liability resulting from the 'long-tail' character of the environmental risk may be met both under third-party and first-party insurance (at least to some extent) by the introduction of a claims-made cover.

The Dutch insurers introduced their new environmental damage insurance with enthusiasm, claiming that they have now been able to increase the manageability and

³⁶ Note, however, that the MSV insurer will in that particular case provide legal aid to his insured.

predictability of the risk. Their basic idea is that it is much easier to monitor and predict the potential of damage *ex ante* with one particular site, than to predict the chances that one operator may be held liable to pay damages to a third party. One important factor of uncertainty (the judge) has thus been excluded. Although one can understand the enthusiasm of the insurers and – to some extent – the corporate world (since under first-party insurance they also receive cover for their own losses) there are clearly disadvantages as well. The major disadvantage is not related at all to the fact that first-party environmental damage insurance would not be an adequate insurance product, but to the fact that the introduction of this new product was accompanied by the abolition of liability insurance for environmental risk. As a result of this, some victims may no longer receive compensation, at least in those cases where the damage insurance does not provide sufficient cover and the polluter is insolvent. Therefore, at the policy level we should examine whether it might be necessary to introduce a compulsory insurance scheme, be it liability- or first-party-based. Given the risk of insolvency we held

that a serious problem of underdeterrence could arise which could be solved by introducing some obligation to provide financial security to cover the environmental risk. In addition, the fact that the Dutch insurers are collectively moving from liability to environmental damage insurance raises questions concerning competition on the insurance market.

Apparently co-operation between insurers in The Netherlands is that close that, although formally the standard policy only is an 'advice', in practice operators can no longer obtain coverage for the liability risk, for instance as a result of soil pollution. This example shows that restrictions on competition on the insurance market may seriously limit product differentiation and thus endanger the insurability of the environmental risk. Consequently an effective competition policy is of utmost importance to guarantee that a large variety of efficient insurance policies is indeed available on the market for environmental risk. Otherwise changes such as the one discussed for The Netherlands could limit rather than enhance the insurability of environmental risk.